

AUDIT AND FINANCE

COUNTY AND CITY BUDGET REVIEW 2003-2004 GRAND JURY REPORT

I. Reason For Investigation

Due to the uncertain fiscal condition of the State of California and the recent downturn of the economy, the Grand Jury elected to review the financial procedures and stability of Solano County and the cities of Benicia, Dixon, Fairfield, Rio Vista, Suisun City, Vacaville and Vallejo.

II. Procedure

The Grand Jury:

- Reviewed budgets and independent audit reports and used the data for this report
- Interviewed Solano County Assistant County Administrator/Budget
- Interviewed Solano County Auditor
- Interviewed City of Benicia Finance Director and Assistant Finance Director
- Interviewed City of Dixon Finance Director
- Interviewed City of Fairfield Finance Director
- Interviewed City of Rio Vista Interim Finance Director
- Interviewed City of Suisun City Mayor and City Manager
- Interviewed City of Vacaville Finance Director
- Interviewed City of Vallejo - City Manager and Interim Finance Director
- Referenced *Reinventing Government* by David Osborne and Ted Gaebler

III. Background

1. The current State budget is reportedly in the worst condition it has ever been in the history of the State, partly due to the recent downturn of the economy. Local public agencies depend a great deal on their share of funding allocations from the State. This income is dependent on the strength of the economy.

2. If the local agencies have not prepared for such an event in the form of a suitable reserve, they must reduce programs and services to the community, lay off employees or look at increasing taxes, fees or other funding sources to offset losses. The problem is compounded by the fact that much of their income is in the hands of those in office in Sacramento.

3. Currently, the State is in a dismal position because it was riding the wave of an economic boom and was not prepared for an economic decline.

Adding to the situation, cities and counties around the State report that:

- Increasing retirement benefit costs will impact fiscal health
- Cutting Vehicle License Fees (VLF) will threaten public safety funding
- Property tax diversion to the State continues to hurt communities

- The State budget process shifts funds from local agencies to balance State budget and precludes local agencies from balancing revenues with expenditures

4. With the election of a new administration in the State and the passage of Propositions 57 and 58, the promise to balance the State budget may even worsen the fiscal position of local agencies. It is uncertain how the new Governor will accomplish his goals, which makes the financial future for cities and counties even more uncertain.

5. The key to riding out an economic downturn is to build an adequate reserve fund into the budget. For local government, there is no requirement to maintain a reserve fund when preparing the budget. Each agency sets its own policy, which can be for the current year or for multiple years.

6. Long-term planning is the solution to increase local agency resiliency to economic uncertainty and downturns without adopting a crisis response in financial decision making. Long-term planning provides stability by taking a long-term view of year-to-year changes and assessing whether a present decision can be supported as envisioned into the future. Even though future planning is based on the best assumptions at hand, history has shown that State, County and City fiscal conditions have peaks and valleys. Therefore, a baseline-operating budget is essential to provide expected services. A few examples of such planning are the City of Fairfield, City of Vacaville and City of Benicia. They all have long-term budget forecasts which have given them financial stability to meet the current financial situation and anticipate upcoming problems.

IV. Findings And Recommendations

Each finding is referenced to the background paragraph number

SOLANO COUNTY

Finding #1 - The total Solano County 2003/04 Budget is \$786,441,725. Of that amount, the General Fund is \$188,675,041. Since the County receives the majority of revenues earmarked for specific programs, it is credited directly to the appropriate department and not to or through the General Fund. The reserve for the General Fund is \$24.9 million or 13.2%. The Board of Supervisors' goal is to have a \$10 million General Fund reserve. However, reserves for operating departments vary with no apparent goal set by policy. (2, 5)

Recommendation #1 - Increase the General Fund reserve to no less than 15%.

Recommendation #1a - Establish a 5% reserve in each department.

Finding #2 - The County develops a Five-Year Fiscal Forecast model budget for the General Fund. It is not detailed but is established by totals of general categories and makes various assumptions about tax increases, license and permit revenues, state reductions, Public Employees Retirement System (PERS) increases and net expenditure increases. Each operating department does not submit multi-year budgets or a similar fiscal forecast. (5)(6)

Recommendation #2 - The County budget procedure is primarily established on a year-to-year basis. Presently, reductions are taking place to deal with the expected shortfall in the 2003-2004 budget with minimal plans for future projected deficits. It is recommended that a multi-year detailed budget forecast be prepared, based on the current facts, figures and trends that are available with the input of all operating departments. Each year the plan should be reviewed and updated to reflect current trends.

Finding #3 - A Five-Year Plan is prepared and updated each year for capital improvements. Funding sources are identified. (5)(6)

Recommendation #3 - Continue the present procedure which provides protection of current county assets and meets future infrastructure needs. Insure that on-going maintenance costs to support and maintain capital improvements are included in future operating budget forecasts.

Finding #4 - Department budgets are established by line items. However, the amounts projected are often overspent, transferred or not expended. The bottom line of the budget is the single source that dictates the financial status of the department. (5)

Recommendation #4 - If line item procedures are used to establish a budget, the department should make projections and expenditures accordingly. Transferring funds from one line item to another should be discouraged, tightly controlled and should require the authorization.

COMMENTS

The County of Solano was recognized for its excellence in financial reporting by the Government Finance Officers Association of the United States. The findings of the June 30, 2003 Audit Report found the County's financial procedures to be within accounting principles generally accepted in the United States. The offices of the Audit/Controller and Assistant County Administrator/Budget are to be commended for their work.

CITY OF BENICIA

Finding #1 - The City of Benicia approves a two-year budget which is reviewed quarterly and updated each year. The General Fund revenues are projected at \$23,206,245 for 2003-2004 and \$23,510,320 for 2004-2005. Capital improvement and maintenance programs are integrated into the biannual budget cycle. (2)(3)(5)(6)

Recommendation #1 - Produce a long term plan (five or ten years), especially for capital improvement projects. This can be reviewed and updated in conjunction with the budget review cycle.

Finding #2 - Benicia's budget reserve level is set by City Council resolution at 20% of proposed expenditures. The General Fund reserve is projected to be \$5,787,910 (25% of General Fund expenditures) at the end of the 2003-2004 fiscal year. The General Fund reserve level has grown from 15% in 1995 to its current level. (5)(6)

Recommendation #2 - Use a city ordinance rather than a resolution to set the budget reserve so that the citizenry will be better informed if reserve levels are reduced. Continue to maintain healthy reserves so that the City is not adversely impacted by State budget problems.

Finding #3 - The City of Benicia's budget includes a conservative projection of revenues for the next two years. For example, although revenue from the VLF was \$1,500,000 in 2002-2003, the City assumed for budgeting purposes that none of those fees would be returned by the State in 2003-2004 or in 2004-2005. At the time of the Grand Jury interview, it appeared that the State might actually reinstate approximately \$500,000 of the VLF. (2)(3)(6)

Recommendation #3 - Continue to forecast using conservative projections of revenues.

Finding #4 - Benicia's budget projects significant increases in expenditures, particularly regarding expenses in the Public Employee Retirement System (PERS). Expenditures for the PERS are anticipated to increase from \$700,000 in 2002-2003 to \$1.9 million in FY 2003-2004 to \$3.2 million in FY 2004-2005 (170% increase followed by a 68% increase). (3)(5)(6)

Recommendation #4 - Continue to monitor this situation. If the PERS increases level off in the next few years, consider establishing a PERS reserve to avoid impacting other city services.

Finding #5 - Benicia's projections of reduced revenues and increased costs were addressed by reducing General Fund expenditures by 6% for the FY 2003-2004, thus maintaining a healthy reserve level. This was achieved by not filling some vacant positions, reducing some purchases, and deferring equipment purchases. These are considered temporary reductions. (1)(2)(4)

Recommendation #5 -The City should continue to monitor the State budget situation. If additional revenue is withdrawn, the City may need more permanent expense reductions or may need to enhance revenue sources.

COMMENTS

The City of Benicia is taking prudent steps to insure its financial well-being despite the uncertainty of revenues and expenditures that are controlled at the State level. The City should be commended for foresight in addressing potential budget issues by increasing reserves and reducing expenses before a crisis situation arises.

CITY OF DIXON

Finding #1 – The City of Dixon General Fund contingency for FY 2003-2004 is set at \$1.6million, which amounts to 15% of operating expense. (2)(6)

Recommendation #1 – This solid reserve should be maintained.

Finding #2 – The 15% reserve, which has been met for the past five years, is set each year by City Council resolution. No ordinance or official policy exists calling for a specific goal. (5)

Recommendation #2 – The reserve should be set by a City Council ordinance which would assure that the public would be alerted if a deviation should be recommended in a future budget.

Finding #3 – Dixon prepares its budgets on an annual rather than a multi-year basis. (6)

Recommendation #3 – The Grand Jury recommends that a multi-year financial plan be prepared based on developing facts, statistics and trends. The plan should be continuously updated as new information becomes available.

Finding #4 – Dixon has a five-year capital improvement program which, together with funding, is updated annually. (5)(6)

Recommendation #4 - Insure that on-going maintenance costs to support and maintain capital improvements are included in future operating budget forecasts.

Finding #5 – Notwithstanding significant cuts in State support, Dixon officials report no cuts in basic services. Officials credit this successful outcome to a conservative spending mindset

reinforced by a rigorous process which screens out all uncertain income from the budgeting process. (1)(2)(6)

Recommendation #5 – Continue this successful defensive budget philosophy.

CITY OF FAIRFIELD

Finding #1 - The most recent approved Fairfield budget is for a two-year time period (2003-2005) with review and adjustment scheduled for mid-2004. Total General Fund revenues are budgeted at \$50,986,000 for 2003-2004 and at \$55,094,000 for 2004-2005. For at least the last 17 years, Fairfield has used long term forecasting (10 year time-frame) in developing yearly budgets. Capital improvement and maintenance programs are integrated into the long-term budget forecast. (5)

Recommendation #1 - Continue this admirable system of long-term forecasting with annual revisions.

Finding #2 - Fairfield's budget reserves are set by City Council resolution. They have historically been set at 20% of General Fund expenditures, but that reserve requirement was reduced to 15% for the current budget. General Fund plus PERS savings reserves at the end of the 2003-2004 budget year are estimated to be \$13,320,000 which is 23.7% of General Fund expenses. Budget reserves have grown from 14.6% in the FY 1998-99 to an estimated 44.5% in 2002-03. (5)

Recommendation #2 - Use a city ordinance rather than a resolution to set the budget reserve so that the citizenry will be better informed if reserve levels are reduced. Spending down reserves during this period of State budget difficulties helps to keep service levels at current standards, but it is not recommended to reduce reserve funds any further.

Finding #3 - About 52% of Fairfield's General Fund revenue is controlled by the State. Based on interviews, several million dollars are at risk under various proposals by the State. For example, in 2002-03 the VLF revenue was \$5,843,000 (11.2 % of General Fund revenue). For 2003-04 the city projected VLF revenue at \$1,988,000 (3.9% of General Fund) and the actual amount that will be forthcoming from the State is still in doubt as of this writing. (1)(3)

Recommendation #3 - Continue to monitor developments at the State level and make necessary adjustments when the impact of various proposals is known.

Finding #4 - Significant increases in expenditures are predicted in the coming years, particularly in personnel costs due to substantial increases in retirement expenses in the PERS and large increases in employee health care costs. The City had established a PERS reserve when the costs were low, but that reserve will be depleted in the 2004-05 fiscal year. (3)

Recommendation #4 - Continue to monitor expense trends and make adjustments as early as possible.

Finding #5 - The City is addressing projected budget shortfalls by a combination of: use of reserves, increasing fees and reducing staff (an estimated 19-20 full-time employees will be eliminated in the 2003-04 fiscal year). (2)

Recommendation #5 - Continue to use long-term forecasts to minimize the impact of budget shortfalls.

COMMENTS

The City of Fairfield provides an excellent model of fiscal planning that will provide the ability to focus on problem areas when fiscal resources are still available.

Fairfield pioneered the use of Expenditure Control Budgets in which budgets are developed at the department level which includes incentives to save money. This model has been adopted by a number of other cities. Fairfield has increased its reserves during the last few years in anticipation of upcoming lean years. This allows the City to phase in budget reductions over time and to minimize disruption of services.

CITY OF RIO VISTA

Finding #1 – As of December 31, 2003, Rio Vista was operating on an interim budget. According to testimony received, the interim budget was created by “tweaking” the previous year’s budget. Therefore, it was inadequate as a realistic operating document. (2)(6)

Recommendation #1 - The council should adopt a workable budget as soon as possible, and in the future abide by Government §§ Code 53900 and 53901.

Finding #2 - The City Council has not established a reserve policy. However, the Council did establish a reserve of \$500,000 or 12% of the General Fund expenditures. This reserve can be expended only by authorization of the City Council. This reserve was created with a General Fund cash transfer. (5)(6)

Recommendation #2- The City should strive to maintain its reserve and establish a 5% reserve in each department by using cost saving procedures and revenue enhancements.

Finding #3 – According to testimony, Rio Vista has had a 200% turn over in personnel during the past three years. The following positions were on an interim basis at the time of the interview: City Manager, Finance Director, Public Works Director, Planning Director, and the contract City Attorney. These positions were vacated by request and/or resignation during a three-month period. In addition, some of the City’s difficulty in maintaining a static work force below the department head level can be attributed to its remote and hazardous location on Highway 12, its pay schedules (which appear to be about 25% lower than surrounding cities) and lack of pay increases. (2)(3)(4)

Recommendation #3 - Rio Vista should develop a competitive pay schedule, attempt to hire and train local residents as much as possible and review the pay schedules for enhancements.

Finding #4 - Rio Vista does not have a multi-year budget plan although the planning for a five-year Capital Improvement Budget is in progress. This will include a study on fees and charges which has not been done in the past ten years. (5)(6)

Recommendation #4 - Rio Vista should develop multi-year budget planning. It might be best to start with a three-year plan and progress to a five-year plan which would be reviewed and revised annually by the City Council.

Finding #5 – According to testimony, the City treasury may seem to be “flush” now, but it is due to one-time developer fees, which will not sustain increases of on-going service costs. The City’s maintenance program is reactive instead of proactive but most of the City’s equipment is new and the replacement fund is healthy. The City is dependent on funding from the State up to 18%.

Therefore, the loss of the VLF and unfunded mandates for capital improvements, such as drain and sewer plant upgrades, could be largely impacted. (3)(4)(5)(6)

Recommendation #5 - A capital improvement and maintenance program will have to be funded.

Finding #6 –Billing procedures, budget status reconciliation and other financial reports were not provided in a timely manner to the City Council due to a lack of an effective accounting system, procedures and employee turnover. The council was unaware of the City’s current financial status. (2)

Recommendation #6 - A new accounting system, which has been selected and is in the process of being installed, needs to be implemented and should include employee training.

Finding #7 - An outside audit was completed in June 2002. It allowed the city to “catch-up” by providing accurate financial information. (5)

Recommendation #7 – As set by California law, cities must have outside independent audits every year and the Council should actively review the audit. The Council should change auditor firms on a regular basis.

CITY OF SUISUN CITY

Finding #1 - The Suisun City Council adopted the budget for the City of Suisun City for FY 2003-2004 on December 2, 2003. The Council has not adopted an ordinance or formal policies on the establishment of the reserve.

The projected General Fund reserve for the year ending June 30, 2004 is \$1,133,764, which is 15.6% of General Fund expenses. The City has a budget stabilization reserve of \$694,280 (9.6% of General Fund expenses). The stabilization reserve was designed to accumulate funds for future downturns in revenues and has been used to make one time capital expenditures and cover the structural gap in years where the revenue was less than expenditures. The total projected reserve fund for the year ending June 30, 2004 is \$1,828,044, which includes the stabilization reserve of \$694,280. (2)(3)(5)

Recommendation #1- The Suisun City City Council should adopt an ordinance that establishes the reserve. Any change to such ordinance would require public notice which advises the citizenry of the community. As set forth in State Government Code §§53900-53901, the budget must be adopted and submitted to the County Auditor no later than 60 days beyond the beginning of the budget period.

Finding #2 – The VLF is \$1,278,500 which is 26.62% of the General Fund revenue for the year 2003-2004. There is some uncertainty at the time of this writing about the actual VLF revenue that will be forthcoming from the State and whether there is still a \$306,000 VLF cut or not. (2)(5)

Recommendation #2 - If the VLF is reduced or eliminated, Suisun City faces grave consequences. Therefore, the City must develop future multi-year budget forecasts that consider all revenues that are subject to state reduction and develop reserves and spending plans that will provide future stability.

Finding #3 - The City does not use multi-year budgets but does prepare multi- year Capital Improvement Projects. (6)

Recommendation # 3 - The Grand Jury recommends that a multi-year financial plan be prepared based on developing facts, statistics and trends. The plan should be continuously updated as new information becomes available.

Finding #4 - In FY 2003-2004, the Redevelopment Agency refinanced its 1993 Bond issue of \$43 million in order to lower the interest. (6)

Recommendation #4 - It is a good practice to review the interest rate on the loans and bonds and the City should continue to explore all possibilities in reducing expenses.

Finding #5 - Due to the reduction in VLF and general revenue, staff reduction has become necessary. (5)

Recommendation #5 – Although reduction of staff is necessary to meet budget shortfalls, each position should be carefully examined as to its contribution to City services.

COMMENTS

There was a general lack of promptness by the City of Suisun City in responding to the series of requests by the Grand Jury.

CITY OF VACAVILLE

Finding #1 - The 2003-2004 approved General Fund revenues are \$46 Million and expenditures of \$46,100,000. The City of Vacaville's Council has directed staff to develop a budget with a 15% reserve. (4) (5) (6)

Recommendation #1 - The reserve should be set by Council ordinance.

Finding #2 - The City's five-year budget projection shows a reduction of the General Fund reserve from 22% to 10.9%. (6)

Recommendation #2 – The five-year plan allows the City adequate time to make necessary adjustments in order to maintain a reserve.

Finding #3 - Vacaville is faced with a \$2,000,000 PERS payment, which is not included in this year's budget or any future budget. (1)(2)(6)

Recommendation #3 - There is a \$1,400,000 PERS reserve available. However, the City must determine how the \$600,000 shortfall will be resolved.

Finding #4 - Vacaville does have a multi-year budget plan. Although the planning forecast is for five years, they do have a long range plan, which represents a "total build out" (City Manager's terminology) of the City. This includes a study on fees and charges and how the City will provide services for new residential developments (by Mello Roos). They have planned and built infrastructure such as water and sewer plants to provide for "total build out". A study is being done (to be completed by January 2004) to make sure that the correct impact fees are imposed on all new development. (5)(6)

Recommendation #4 - The City should be congratulated for foresight and planning and should forward to the Grand Jury a copy of the study when completed.

Finding #5 - The City has funding available for interdepartmental loans at a competitive interest rate which may be used for projects. (1)(2)

Recommendation #5 - The City should continue to authorize these loans by Council action and insure that a repayment schedule is included in the council action/resolution.

COMMENTS

Vacaville has a very aggressive Redevelopment Agency which draws new business into the city and thereby increases revenues. Each department operates at City Council performance standards which set goals and objectives. The City uses developer fees to fund capital improvement projects. The City has been able to maintain a 15 to 20% general fund reserve during the past five years.

CITY OF VALLEJO

Finding #1 – The 2003-2004 approved General Fund revenues are \$73,944,400 and expenditures of \$73,367,100. In the last five years, the City has gone from a deficit budget to a current General Fund reserve of \$3,900,000. The entire budget reserve is \$7,846,315 or 11.8%, which includes reserve for insurance, inventory and economic uncertainties. (5)(6)

Recommendation #1 - Continue to work towards the City Council-established policy of a 15% General Fund reserve.

Finding #2 - To balance this year's budget, an early retirement plan was implemented to reduce the workforce by 12 employees. In addition, a grant writer was employed to secure available funds for various programs. (2)

Recommendation #2 - Continue to seek grants and review each vacant staff position as to need for replacement.

Finding #3 – Annually, a five-year plan is prepared and presented to the City Council. It assumes the current economic conditions and does not address any future economic trends and growth pattern needs. (5)(6)

Recommendation #3 - It is recommended that a detailed, multi-year financial plan be prepared, based on the current facts, figures and trends that are available. Each year the plan should be reviewed and updated to reflect current trends.

Finding #4 - The City has a five-year Capital Improvement Program, which is reviewed and updated each year. (5)(6)

Recommendation #4 - Continue the present procedure which provides protection of current city assets and meets future infrastructure needs. Ensure that on-going maintenance costs to support and maintain capital improvements are included in future operating budget forecasts.

V. GENERAL RECOMMENDATIONS FOR THE COUNTY AND CITIES WITHIN

- Implement a Supervisor/City Council-adopted policy that instructs staff to prepare **detailed** budget forecasts, based on the best economic assumptions at hand, for a period of no less than five years. (5)

- Develop and maintain a General Fund Reserve and a Contingency Fund of no less than 15% in combination. (2)(6)
- Cities must file with the County Auditor a copy of their annual budget within sixty (60) days after the beginning of the fiscal year (California State Government Code Section 53900-53901).
- The County and Cities through their organizations (League of California Cities and the State Association of Counties) should work toward changing the state constitution to correct the structural flaws in the state's finance system of local agency funding. This would protect county and cities' general revenues from future diversions or cost shifts. (3)
- Change audit firms on a periodic basis.

VI. Comments

As long as legislators in Sacramento continue to change the funding basis for local agencies, it will be virtually impossible on a year-to-year basis to determine what resources are available for basic community services, especially, if there is a major downturn in the economy and spending was built on a high point. California has an economic history that has peaks and valleys, and counties and cities should be aware that this situation is not unique at this point in time. By considering historical data, local growth projections and basic community service needs, long-term planning can take place and provide budget reserve information that will protect agencies when adverse situations, as we currently see today, take place. There are models of such planning throughout the state that have been prepared in detail to create long term budget forecasts. When agencies using these procedures are examined, the majority are found to be in good financial position to deal with the uncertainties that the State financial procedures create.

VII. Affected Agencies

- City of Benicia
- City of Dixon
- City of Fairfield
- City of Rio Vista
- City of Suisun City
- City of Vacaville
- City of Vallejo
- Solano County Board of Supervisors
- Solano County Auditor/Controller